OBAYASHI

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OBAYASHI CORPORATION

Summary of the Financial Results Briefing Conference
for FY2024 (April 1, 2024 to March 31, 2025)

Date:	Wednesday, May 14, 2024, from 10:30 to 11:50
Respondents:	Toshimi Sato, President and CEO
	Atsushi Sasagawa, Executive Vice President
	Yoshihito Sasaki, Executive Vice President
	Yasuo Morita, Executive Vice President
	Yoshiaki Takata, General Manager of Accounting Department
Attendees:	111 securities analysts, institutional investors and others

1. Presentation on Financial Results for FY2024, Forecasts for FY2025, and Progress in Addendum to Medium-Term Business Plan 2022 and Capital Policy

An explanation was provided by the President and CEO, based on the Presentation on Financial Results for FY2024.

2. Main Questions and Answers

(1) Outlook for FY2025

Q. Although profits are expected to decrease in FY2025, they are projected to improve in FY2026 as large-scale unprofitable projects in the domestic building construction business will be completed by the end of FY2025. Will your FY2026 results, including those in the civil engineering business and subsidiaries, exceed results for FY2024?

A. For FY2025, we disclosed the same figures as our business plan, as in the past. Although we did not disclose forecasts for FY2026 and beyond, we are studying them as we formulate our 2025 business plan. While there are still uncertainties, such as moves by the Trump administration and the ongoing situation in Ukraine, assuming no major changes in the business environment, we believe that operating income will bottom out in FY2025 and that from FY2026 onward we must achieve an operating income equal to or higher than FY 2024. Profit attributable to owners of parent will vary according to the degree of progress in selling cross-shareholdings.

Q. Regarding the impact of the Trump administration’s reciprocal tariff policy, although some domestic construction companies in Japan have suggested that the impact will not be substantial, is Obayashi concerned about a possible economic downturn in North America due to the large weighting of its North American operations? Alternatively, is there concern that there may be a ripple effect on the Japanese domestic market?

A. Although the globalization of the supply chain makes it difficult at this point to predict how the price and quantity of construction materials will be affected over the short term, we believe that there will be an impact, and accordingly, we need to keep a close watch on the situation. Over the long term, we believe that tariffs have the potential to impact our customers' operations, particularly in terms of capital expenditures, which could dampen demand. Our North American subsidiaries are affected by interest rates irrespective of the Trump tariffs, and while we will continue to monitor interest rates closely, if the outlook for recovery will require some time, each of these companies will need to consider their next strategies accordingly.

(2) Domestic Building Construction Business

Q. Why was the gross profit margin on completed construction contracts 9.7% in FY2025, compared to 9.1% in FY2024? The margin of improvement seems small considering that large-scale, low-profitability projects have now been completed. Are there currently low-profitability projects in hand? Please explain the basis for this forecast, including details of the conditions you anticipate and the future directionality.

A. We have been working to secure new orders while aiming to improve profitability, and we are also striving to make productivity improvements at our construction sites as well as to achieve an efficient supply chain. Through these efforts, we aim to achieve a gross profit margin of 10% or higher.

Please take into account that in FY2025, projects with a provision for loss on construction contracts represent about 10% of total net sales of completed construction contracts which will reduce our profit margin by one percentage point.

Q. Labor and personnel costs continue to rise—are there any risks of a further increase going forward?

A. According to the Japan Federation of Construction Contractors, labor costs have risen almost 30% since 2021. We expect this increase to continue due to labor shortages and market wage increases, and anticipate that labor costs will peak in FY2026 when our construction volume is at its peak.

Q. How did profitability at the time of receiving orders improve in FY2024, and what is the outlook for FY2025?

A. Our balance of projects in process exceeds 1.9 trillion yen, and we have a reasonably clear forecast for projects to be completed by 2028, about four years from now. Under such conditions, we are also often requested to handle sole source orders, and the ratio of sole source orders currently stands at around 60%. There are also instances of single-company bidding, which has eased the competitive environment. While we expect the recent seller's market to continue for the foreseeable future, at the same time the brakes are being applied to some capital investment projects in the semiconductor, storage battery, and data center sectors, and the U.S. reciprocal tariff policies have added uncertainty. Accordingly, we do not expect the current conditions to continue indefinitely, and as such will watch the flow of the tide and take appropriate action.

Although profitability is close to the peak levels seen in the 2016-2017 period, there are some projects in which discussions with the client have become drawn out and some instances where projects have had to be canceled due to a significant deviation from the customer’s budget as a result of rising construction costs. Accordingly, we believe that it will be difficult to continuously increase profitability at the time of receiving orders. To maintain relationships with our key customers, we will make prudent decisions regarding orders to avoid future setbacks.

Q. Does the above response mean that as you have substantial construction work in hand, you do not need to lower profit margins to win orders, despite some signs of a potential slowdown?

A. By no means do we intend to lower profit margins in pursuit of new orders. Profitability at the time of receiving orders is currently already high, and it is unlikely that this margin will continue to rise further in a sustained upward trend. With regard to our order receipt strategy, we believe it is important to secure a wide variety of orders, encompassing not only super-large scale projects but also small- and medium-sized projects, not only due to size and purpose but also from the perspective of work site management and human resource development. We will receive orders with the aim of building an appropriate project portfolio.

(3) Domestic Civil Engineering Business

Q. I would like to confirm some details regarding the gross profit margin on completed construction contracts. What was the reason for the significant improvement in FY2024? In addition, although your guidance for FY2025 is higher than previous years, is there a possibility that this will trend upward as it did in FY2024? In addition, is there a possibility that this margin will continue to exceed 17% in FY2026 and beyond?

A. Profit in FY2024 was boosted significantly by a large volume of completed construction contracts, as well as by cost reductions and additional claim approvals for design changes. While figures for FY2025 incorporate revenue from additional claim approvals that can be anticipated at this stage, we remain thoroughly committed to improving profitability.

In FY2026 and beyond, we anticipate a significant increase in construction volume due to the substantial amount of construction projects in hand resulting from a large increase in orders received in FY2024, and we are making preparations and implementing measures to prepare for this increase. We expect to be able to achieve profit margins comparable to FY2025 levels.

(4) Real Estate Development Business

Q. With regard to 60 Gracechurch Street (p. 44 of the Presentation on Financial Results for FY2024), what specific asset types or areas do you envision to further diversify your rental portfolio? In addition, the market value of your rental properties at the end of the fiscal year was 760.0 billion yen (p. 10 of the FY2024 Supplementary Data on Financial Results)—is there a possibility that the scale of your assets will increase as you diversify your portfolio?

A. In London, we currently have three office buildings in the City alone, the first being Bracken House in 1987. Risks in the City are limited as the business environment is stable, vacancy rates remain low even during peak periods in the U.K., rent levels are stable and trending upward, and U.K. rental contracts are long-term and rent reviews are upward-only.

With regard to the question of whether there is any risk of a further expansion of approximately 700.0 billion yen in our development assets, we are currently discussing the future direction of our real estate development business based on the perspective of what and where we should focus on to enhance our corporate value, before we consider the scale of our assets. With regard to new asset types in Japan, once again we will make decisions based on whether these assets serve to enhance our corporate value. However, we do not intend to drastically increase the size of our current 700.0 billion yen asset base. We will continue working to replace old properties through off-balance sheet transactions via private funds and by selling older properties.

(5) Efficiency Indicators and Capital Policy

Q. What do you perceive as the challenges in improving your ROE? In addition, what strategies do you plan to address these challenges?

A. As we have stated in our capital policy, we must control the denominator of the ROE equation while at the same time ensuring solid growth in the numerator, which is a key challenge in our Medium-Term Business Plan 2022. Specifically, we are strengthening the foundation of the domestic construction business to lay a base for future growth. We are also working to sow the seeds for the next phase of growth. These efforts will feed into the next medium-term business plan, and we are currently working internally to study this as part of our growth strategy.

Although our financial results are generally in line with the business environment we envisioned when we formulated our Medium-Term Management Plan 2022, in some aspects the details differ from those we had anticipated. We believe that we must study how to better anticipate future trends as well as how to respond to these factors. While backcasting is one approach, in reality the Obayashi Group must identify the risks it faces in a constantly changing market environment and have a number of options for handling those risks. In addition to achieving numerical targets, in order to realize sustainable growth we also believe it is important to have a range of tools available to respond to short-term changes in the business environment.

Q. The performance indicator target for ROE of 10% or higher is based on the estimated cost of capital as of 2023. However, rising interest rates means that the risk-free rate also rises, which in turn raises the required cost of capital. Shouldn’t you raise your target ROE in line with this trend?

A. As you noted, we acknowledge the need to adjust our targets based on changes in the cost of capital in each market, including the interest rate environment. Although the ROE target for the Group as a whole is 10%, the ratio of consolidated results to non-consolidated results within the Group is currently more than 1.5 times, and we must examine the cost of capital required in each of the domestic and overseas markets for the building and civil engineering business, real estate development business, and green energy business, and whether we are winning in those markets on a business-by-business basis. We recognize that in the future we must present ROE/ROIC for each business and, for example, the businesses’ respective ROA on a consolidated basis. With regard to the point you raised, as the return on equity for the Obayashi Group as a whole varies depending on the business portfolio as well as interest rates, we will continue discussing this issue at the Board of Directors and disclose information in the event of any major changes in the future.

Q. You have exceeded an equity level of 1 trillion yen—do you consider this level appropriate?

A. While we consider a level of 1 trillion yen appropriate given our current business portfolio, we do not consider 1 trillion yen an absolute line. We do not plan to change the necessary equity level at this point in time, but will explain to the market when it becomes necessary to increase capital, for example, when bond capacity in the North American business approaches the maximum limit or when it becomes necessary to secure additional bonding facilities.

Q. In the construction industry, where use of cash is subject to large fluctuations depending on economic conditions, pursuing M&A more proactively also benefits shareholders, while investment is also important in order to strengthen and accelerate profit generation not only in the construction business, but also in non-construction businesses. What is your approach to investment in the next Medium-Term Business Plan?

A. We agree with your view. With regard to the North American business, with MWH, KRAEMER, and WEBCOR growing in size, we are working toward the next step of formulating a grand design for our business strategy in North America. In Asia, although Thai Obayashi has driven profitability to date, we are currently increasing profits in our Singapore and Indonesia operations as well. In addition, we are studying M&A opportunities to expand our business in Oceania. We have established a team at Head Office to examine M&A opportunities, and we will pursue M&As based on a strategic and systematic analysis of the market. However, in the case of large-scale acquisitions where the ownership is held by a fund, there may be cases where the acquisition price equals goodwill. We recognize this as one issue in the Obayashi Group's M&A strategy, and will study ways to address this matter. We will report on this matter in the future as progress is made.

Q. Regarding the 1 trillion yen level for equity, although the concept of maintaining sufficient equity was well received by the market, at the time of announcement, there was no explanation as to why the target was set at 1 trillion yen. Can you give us a concrete breakdown of this target and how you put it together, as well as the logic behind the increasing equity as the company's business grows? In addition, do you have any plans to disclose this information in the future?

A. We have not disclosed the rationale for the 1 trillion yen level, but you can think of it as the aggregate of the required equity for each of our businesses. The figure was calculated based on an analysis of what the ROE of the Obayashi Group as a whole would be, based on the cost of capital if each business portfolio were to have its own separate balance sheet. In the future, we believe that it will be necessary to disclose to the market the cost of capital for each of our business portfolios and how we intend to operate each business and at what level of ROE. However, we cannot give a specific time frame for disclosing this information.

Q. I imagine that it is difficult to disclose figures by division due to the competitive sensitivity of this information. However, when considering the overall balance of the balance sheet, couldn't you disclose the allocation of working capital and non-working capital, including M&A and reserves for contingencies, at an earlier timing? Again, regarding cross-shareholdings, it is not a matter of simply reducing holdings below 20% of consolidated net assets —we believe that there should be a discussion on how much should be held in the first place.

A. As our business expands, in addition to examining the Group's organizational structure, such as whether all of our businesses should be operated under our holding company Obayashi Corporation, we understand the need to discuss details such as working capital and the amount of reserve funds for contingencies, and we will disclose our views on these issues.

(6) Shareholder Returns

Q. I would like to clarify your approach to shareholder returns. Your cash allocation plan (p. 35 of the Presentation on Financial Results for FY2024) assumes an operating income of 100.0 billion yen, but the actual figure is significantly higher. You have already announced plans to buy back share totaling approximately 100.0 billion yen over the period of the Medium-Term Business Plan 2022, but is there a possibility that you will have further capacity for shareholder returns as a control of equity? If so, will you buy back shares or enhance dividends?

A. We will maintain a DOE of 5% based on our policy of providing stable dividends over the long term, and will proceed with the 100.0 billion yen share buyback as planned unless there are major changes in the business environment. Although this amount is based on financial projections through to the final year of the Medium-Term Business Plan 2022, it is not the goal, and we will continue to adopt an appropriate capital policy from the next medium-term business plan and beyond. How we approach this will depend on the situation at the time, such as revising the DOE level if we project that we will be able to maintain the same level of performance over the medium- to long-term, or repurchasing shares in the short term. We are not currently discussing adding a special dividend to DOE.

Q. Of the 100.0 billion yen in share buybacks to be implemented by March 2027, are there any metrics or other criteria for implementation of the remaining 70.0 billion yen after deducting the 30.0 billion yen to be implemented through to the end of June 2025? In addition, with equity well in excess of 1 trillion yen, is there a possibility of additional buybacks?

A. Unless there are unexpected and significant changes in the business environment, there will be no changes to the 100.0 billion yen share buyback during the Medium-Term Business Plan 2022 period. Regarding the remaining 70.0 billion yen, we are unable to provide an answer as to the timing and amount of implementation. In order to maintain 1 trillion yen in equity, which we have announced as the required level for our current business portfolio, as explained earlier, we will make decisions on reviewing DOE or share buybacks in accordance with the situation at the time.